STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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June 9, 2006

Dear Interested Party:

Staff has reviewed comments received in response to the May 2, 2006, interested parties meeting regarding potential amendments to California Code of Regulations, title 18, section 1571 (Regulation 1571), *Florists*. After considering the comments and information provided to date, staff is recommending amendments to Regulation 1571. In particular, staff recommends amending Regulation 1571 to define "florist" to only include retailers who sell flowers through floral delivery associations, unless the retailer merely gathers orders to forward to other florists for fulfillment and delivery.

Enclosed is the *Second Discussion Paper* on this subject. This document provides more background information, a discussion of the issue to be addressed, and explains staff's recommendation in more detail. Also enclosed for your review is a copy of the proposed amendments to Regulation 1571 (Exhibit 1).

A second interested parties meeting is scheduled for **June 22, 2006, in Room 122,** to discuss the proposed amendments to Regulation 1571. If you are unable to attend the meeting, but would like to provide comments for discussion at the meeting, please feel free to write to me at the above address or send a fax to (916) 322-4530 before the June 22 meeting. If you are aware of other persons that may be interested in attending the meeting or submitting comments, please feel free to provide them with a copy of the enclosed materials, and invite them to attend the meeting. If you plan to attend the meeting on June 22, or would like to participate via teleconference, I would appreciate it if you would let staff know by contacting Ms. Lynn Whitaker by telephone at (916) 324-8483 or by e-mail at Lynn.Whitaker@boe.ca.gov prior to June 15, 2006. Advance notice will allow staff to make alternative arrangements if attendance is expected to exceed the maximum capacity of Room 122, and also to arrange for teleconferencing.

Any comments you may wish to submit subsequent to the June 22, 2006, meeting must be received by **July 7, 2006**, and should be submitted in writing to the above address. After considering all comments, staff will complete a formal issue paper on the proposed amendments to Regulation 1571 for discussion at the **Business Taxes Committee meeting** scheduled for August 29, 2006. Copies of the formal issue paper will be mailed to you approximately ten days prior to the August 29 meeting. Your attendance at the August 29, Business Taxes Committee meeting is welcomed and encouraged. The meeting is scheduled for **9:30 a.m.** in Room 121 at 450 N Street, Sacramento, California.

Please be aware that copies of any materials you submit may be provided to other interested parties. Therefore, please ensure your comments do not contain confidential information.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Business Taxes Committee" page on the Board's Internet Web site (http://www.boe.ca.gov/meetings/btcommittee.htm) for copies of the committee's procedures manual, and discussion or issue papers, meeting minutes, and calendars, which are arranged according to subject matter and month.

We look forward to your comments and suggestions. Should you have any questions, please feel free to contact Mr. Geoffrey E. Lyle, Supervisor, Business Taxes Committee and Training Section at (916) 322-0849.

Sincerely,

Jeffrey L. McGuire, Chief
Tax Policy Division
Sales and Use Tax Department

JLM:llw

Enclosures

cc: (all with enclosures)
Honorable John Chiang, Chair
Honorable Claude Parrish, Vice Chairman
Ms. Betty T. Yee, Acting Member, First District (MIC 71)
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable Steve Westly, State Controller, C/O Ms. Marcy Jo Mandel (MIC 73)
Mr. Chris Schutz, Board Member's Office, Fourth District (MIC 72)
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)
Mr. Romeo Vinzon, Board Member's Office, Third District (via e-mail)
Mr. Alan LoFaso, Board Member's Office, First District (via e-mail)
Mr. Steve Kamp, Board Member's Office, First District (MIC 71)
Ms. Mira Tonis, Board Member's Office, First District (via e-mail)
Ms. Margaret Pennington, Board Member's Office, Second District (via e-mail)
Mr. Lee Williams, Board Member's Office, Second District (MIC 78 and via e-mail)
Mr. Ramon J. Hirsig (MIC 73)
Ms. Kristine Cazadd (MIC 83)
Ms. Randie L. Henry (MIC 43)
Mr. Robert Lambert (MIC 82)
Mr. Randy Ferris (MIC 82)
Mr. Brad Heller (MIC 82)
Ms. Janice Thurston (via e-mail)
Ms. Jean Ogrod (via e-mail)

Mr. Jeff Vest (via e-mail)
Mr. David Levine (MIC 85)
Mr. Steve Ryan (MIC 85)
Mr. Todd Gilman (MIC 70)
Mr. Kenneth Topper (via e-mail)
Mr. Dave Hayes (MIC 67)
Ms. Freda Orendt (via e-mail)
Mr. Stephen Rudd (via e-mail)
Mr. Joseph Young (via e-mail)
Mr. Vic Anderson (MIC 44 and via e-mail)
Mr. Larry Bergkamp (via e-mail)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Leila Khabbaz (MIC 50)
Ms. Lynn Whitaker (MIC 50)
Mr. Dave Rosenthal (MIC 50)

SECOND DISCUSSION PAPER

Proposed revisions to Regulation 1571, *Florists*, to clarify the application of tax to sales by florists

I. Issue

Should California Code of Regulations, title 18, section (Regulation) 1571, *Florists*, be amended to exclude certain sellers of delivered flowers from its application?

II. Staff Recommendation

In recognition of changes to the floral industry, staff recommends amending Regulation 1571 to define "florist" to include retailers who sell flowers through floral delivery associations, unless the retailer merely gathers orders to forward to other florists and does not fill floral orders themselves. Retailers that do not use a floral delivery association, or use a floral delivery association, but only gather orders to forward to other florists for fulfillment and delivery, would report tax on sales delivered in California. When delivery is outside California, those retailers would report their sales as provided in Regulation 1620, *Interstate and Foreign Commerce*. Staff's proposed revisions are attached as Exhibit 1.

III. Other Alternative(s) Considered

Do not amend Regulation 1571, *Florists*.

IV. Background

Regulation 1571, *Florists*, was first adopted as Ruling 42 in 1933 to explain the application of tax to sales of floral arrangements where one florist accepts the order and instructs another florist to make the delivery. The regulation was amended in 1971 to clarify the charges that are included in the measure of tax, but the manner in which tax applies has remained the same since 1933.

When a purchaser places an order with a florist and the order requires the florist to deliver flowers to a recipient outside the florist's delivery area, the florist taking the order will typically send the order to a florist near the recipient for fulfillment and delivery. Most florists are members of floral delivery associations (e.g., FTD, Teleflora) and the ordering, fulfillment, and delivery of flowers are often completed through affiliated members of these networks. In the past few years, however, some Internet-based florists have developed alternative systems to fill and deliver flower orders.

At issue are orders taken by California florists for the delivery of flowers outside California. Under the current provisions of Regulation 1571, tax applies to amounts charged by California florists for such orders even though another florist fills the order and makes the delivery outside California. Tax does not apply to amounts received by California florists for making deliveries in California pursuant to instructions received from other florists. The term "florist" is not defined in Regulation 1571, but historically, the provisions of the regulation have been applied to all sellers of delivered flower arrangements, wreaths, etc.

SECOND DISCUSSION PAPER

Proposed revisions to Regulation 1571, *Florists*, to clarify the application of tax to sales by florists

The application of tax to out-of-state sales by florists was discussed in two separate cases heard by the Board in March 2002 and February 2006, respectively, which were decided in favor of the taxpayers. Both cases involved taxpayers who were located in California, but sold flowers exclusively through their Web sites and toll-free telephone numbers. In the first case, the taxpayer did not use a floral delivery association to fulfill and deliver orders. Instead, the taxpayer forwarded orders to: (1) growers who combined their own flowers with accessories provided by the taxpayer and shipped the arrangements by common carrier; or (2) packers who prepared the arrangements using flowers and accessories provided by the taxpayer and shipped the arrangements by common carrier. In the second case, the taxpayer used a floral delivery association; however, the taxpayer was a "send only" florist, meaning the taxpayer sent all orders to other florists for fulfillment and delivery, and did not fulfill any orders itself.

In both cases, the taxpayers pointed out that the current rules for florists were developed for florists who operate traditional flower shops. Since these taxpayers did not fit the business model that Regulation 1571 was promulgated to address, these Internet-based retailers of flowers argued that they should not be considered "florists" for purposes of applying Regulation 1571. Rather, the taxpayers believed their sales for out-of-state delivery should be reported under the standard rules for interstate and foreign commerce transactions provided in Regulation 1620. The Board found in favor of both taxpayers and referred the issue to the Business Taxes Committee (BTC) for review.

An interested parties meeting was held on May 2, 2006 to discuss possible amendments to Regulation 1571. Following the interested parties meeting, staff received comments from Mr. Robert Cendejas, representing JustFlowers.com; Mr. Richard Matteis, representing the California State Floral Association; and Mr. Jordan Weiss, representing Teleflora LLC. Their comments are attached as Exhibits 2, 3, and 4.

The BTC is scheduled to discuss this issue at its meeting on August 29, 2006.

V. Discussion

In the Initial Discussion Paper, staff discussed excluding florists from the provisions of Regulation 1571 if their transactions did not involve reciprocal agreements with floral delivery associations. That is, the florist would have to both send and receive orders through a floral delivery association in order to report based on Regulation 1571. Based on discussion at the May 2 interested parties meeting and the written comments from interested parties, staff believes a better approach would be to define "florist" for purposes of Regulation 1571 to include retailers who sell flowers through floral delivery associations, unless the retailers merely gather orders to forward to other florists and do not fill floral orders themselves. A retailer who does not meet this definition of "florist" would report sales delivered outside California under the provisions of Regulation 1620, *Interstate and Foreign Commerce*. Traditional retail florists, however, would continue to report their sales based on the current provisions of Regulation 1571.

SECOND DISCUSSION PAPER

Proposed revisions to Regulation 1571, *Florists*, to clarify the application of tax to sales by florists

The following examples illustrate the application of tax under staff's proposed revisions:

Example 1 – Traditional Retail Florist

The taxpayer operates a flower shop in California. The taxpayer takes orders from walk-in customers, over the phone, and through the store's Web site. When orders are placed for delivery outside the florist's area, the orders are sent via a floral delivery association to other florists for fulfillment and delivery. The taxpayer also receives orders from other florists to fill and deliver flowers to recipients in the taxpayer's area.

In this example, tax will apply as it does under the current provisions of Regulation 1571. The taxpayer should report tax on amounts it charges to its customers for the delivery of flowers, wreaths, etc., whether delivery is in California or outside California. Tax does not apply to amounts received by the taxpayer for deliveries made pursuant to instructions received from another florist.

Example 2 – Order Gatherer

The taxpayer does not operate a flower shop or own an inventory of flowers; floral arrangements are sold exclusively through the taxpayer's Web site and toll-free telephone number. Orders are sent through a floral delivery association to other florists for fulfillment and delivery. The taxpayer never fills or delivers orders itself.

In this example, the taxpayer is not a florist under the proposed provisions of Regulation 1571. The taxpayer would be subject to sales tax on sales made in California and delivered in California, and required to collect use tax on all sales made outside of California for delivery in California, if the taxpayer was doing business in California under Revenue and Taxation Code section 6203 (i.e., has "nexus" with California) or is registered to collect California use tax. The taxpayer would not report California sales or use tax on sales for delivery outside California. Other florists under the provisions of Regulation 1571 receiving orders from the taxpayer via the floral delivery association would not be subject to tax upon the amounts they receive for fulfilling and delivering the taxpayer's orders.

Example 3 – Retailer Not Using a Floral Delivery Association

The taxpayer does not operate a flower shop; floral arrangements are sold exclusively through the taxpayer's Web site and toll-free telephone number. Some orders are forwarded to flower growers who assemble arrangements using their own flowers and vases/shipping materials provided by the taxpayer. Other orders are forwarded to packers who assemble arrangements using flowers, vases, and shipping materials provided by the taxpayer. All orders are shipped by common carrier.

In this example, the taxpayer is not a florist under the proposed provisions of Regulation 1571. The taxpayer would be subject to sales tax on sales made in California and delivered in California, and required to collect use tax on all sales made outside of California for delivery in California, if the taxpayer has nexus with California or is registered to collect California use tax. The taxpayer would not report California tax on sales for delivery outside California.

SECOND DISCUSSION PAPER

Proposed revisions to Regulation 1571, *Florists*, to clarify the application of tax to sales by florists

Staff believes the proposed revisions address interested parties' concerns. In his submission, Mr. Robert Cendejas recommended that Regulation 1571 be clarified to indicate that it does not apply to "send-only" florists (i.e., florists who are members of a floral delivery association, but do not fulfill orders for other florists). The proposed amendments follow this recommendation as illustrated in Example 2 above.

Mr. Richard Matteis from the California State Floral Association commented that, "…we do not see how having a reciprocal agreement with a floral delivery association is pertinent to the discussion about changing Regulation 1571. CSFA does not see this as relevant." Staff's recommendation defines "florist" for the purposes of Regulation 1571 without using the reciprocal agreement terminology. Instead, it refers to members of floral delivery associations in a manner that was borrowed from a New York regulation addressing similar issues. [See 20 N.Y.C.R.R., § 526.7 (Regulation 526.7), subd. (e)(3).] Staff believes the proposed revisions separate traditional retail florists from the Internet-based flower retailers described in the cases heard by the Board, without referring to the specific types of agreements florists enter into with their floral delivery associations.

Mr. Jordan Weiss stated in his submission that, "Teleflora accepts that some minor clarification of the Regulation may be in order. However, (a) the existence or absence of a reciprocal agreement with a floral delivery association should not be a determining factor; and (b) any change should continue to protect the retail florist who fulfills the order from responsibility to collect or remit tax, regardless of whether the order originates from a traditional retail florist or other floral sales business, or the domestic or international tax jurisdiction from which the order is received." Mr. Weiss further explains, "In the floral industry, businesses that do business strictly on a remote sales basis, whether over the Internet or through central call centers, are commonly referred to as 'order gatherers' to distinguish such floral sales businesses from traditional florists. Although all businesses that sell floral arrangements might be referred to as 'florists' in a very general sense, the industry recognizes that it is less appropriate to refer to businesses that fulfill all orders through others as 'florists' within the common usage of the term."

Again, staff's recommendation defines "florist" for purposes of Regulation 1571 without using the reciprocal agreement terminology. The recommended revisions recognize Mr. Weiss' distinction between "order gatherer" florists and traditional retail florists, and exclude mere order gatherers from the definition of "florist" for purposes of Regulation 1571. Retailers who meet the definition of "florist" would continue not to be responsible for tax on amounts received for the delivery of flowers in California pursuant to instructions received from other florists or retailers.

Staff's proposal excludes (1) retailers that do not use a floral delivery association to fill and deliver orders, and (2) retailers that use a floral delivery association but only gather orders to forward to other florists from the definition of "florist" for the purposes of Regulation 1571. The purpose of this language is to address the circumstances in both florist cases heard by the Board. Further, the proposed revisions retain the long-standing rules that have worked well for

traditional florists for over 70 years while recognizing the needs of a new industry business model. The change in reporting out-of-state sales is also supported by RTC section 6396.

In general, absent any exemption, sales tax is imposed upon retailers for the privilege of selling tangible personal property at retail in California (RTC § 6051). The measure of tax is the retailer's gross receipts from retail sales (RTC § 6012). The place of sale is the place where the property is physically located at the time the act constituting the sale takes place (RTC § 6010.5). RTC section 6396 provides an exemption from the sales tax for "the gross receipts from the sale of tangible personal property which, pursuant to the contract of sale, is required to be shipped and is shipped to a point outside this state by the retailer" via the retailer's own facilities or a common carrier, customs broker or forwarding agent.

Staff further believes the proposed revisions are compatible with the florist regulations in other states to the fullest extent possible. Reporting tax based on the destination of the floral delivery may eventually be required under the Streamlined Sales and Use Tax Agreement (SSUTA) for all florists.

Sales by florists in other states

When flowers are sold through a florist delivery association, all states follow rules similar to the current provisions of Regulation 1571. While staff's research did not show any state that excluded "order gatherer" florists from their regulations for florists, some states do make a distinction between sales that are not made through a floral delivery association. For example, when florists make sales for the delivery of flowers, wreaths, etc. in New York without using a florist's telegraphic or telephonic delivery association, the place of delivery controls the incident and rate of New York tax. Thus, if a New York florist receives an order from a customer to prepare and deliver flowers outside of New York State, the receipts from the sale are not subject to New York tax because delivery occurs outside the state. (Regulation 526.7, subd. (e)(3)(iii)). In addition, members of the Streamlined Sales and Use Tax Agreement (SSUTA) will apply destination based sourcing rules when the proposed SSUTA florist rules go into effect, if ever.

Streamlined Sales and Use Tax Agreement: Organized in March 2000, the SSUTA is an effort by state governments to simplify the administration and collection of sales and use taxes. Among the goals of the project are to provide states with uniform definitions, simplified rates, and uniform sourcing rules.

With regard to florists, the SSUTA provides that in the case of floral orders taken by one florist and transmitted to another florist for delivery, the florist taking and transmitting the order shall be deemed to be the seller for purposes of liability for sales and use tax regardless of whether the transmitting florist is registered to collect and remit sales and use tax in the state where the sale is sourced. In addition, the agreement provides that when the property is not received by the purchaser at a business location of the seller, the sale is sourced to the location where the purchaser (or the purchaser's donee, designated as such by the purchaser) receives the product, including the location indicated by instructions for delivery to the purchaser (or donee), known

to the seller. (See SSUTA, § 310.) In other words, under the SSUTA, the florist who makes the retail sale (sends the order to the receiving florist) will be responsible for collecting and remitting the tax that is in effect at the location where the property is delivered. (If and when the SSUTA rules for florists go into effect, florists will be responsible for tax based on destination when flowers are delivered in a state participating in the SSUTA; florists will not be responsible for collection of tax in non-participating states.) Implementation of the SSUTA sourcing rules for florists has been delayed until January 1, 2008.

Key to all of the states' regulations, including SSUTA member states, is the provision that the person responsible for the tax is the florist/retailer who takes the initial order from the customer. In general, staff's proposed changes are consistent with that provision. However, under the proposed amendments to Regulation 1571, the exception to that general rule would be the presumably rare drop shipment scenario involving an out-of-state non-florist without nexus using a California non-florist to drop ship to a California customer or donee. In this situation, the California non-florist would be responsible for reporting California tax as explained in Regulation 1706, *Drop Shipments*. For example, if an out-of-state non-florist without nexus in California has a California grower drop ship flowers to a California customer, the grower would be responsible for reporting California tax as a drop shipper.

VI. Summary

Staff recommends amending Regulation 1571 to define "florist" to include retailers who sell flowers through floral delivery associations unless the retailer merely gathers orders to forward to other florists and does not fill floral orders themselves. Retailers that do not use a floral delivery association, or use floral delivery association but only gather orders to forward to other florists for fulfillment and delivery, would report tax on sales delivered in California. Staff further recommends that the current provisions of Regulation 1571 should continue to apply to traditional retail florists. Interested parties are welcome to submit comments or suggestions on this issue and are invited to participate in the interested parties meeting scheduled for June 22, 2006, in Sacramento.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 06/08/2006

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REGULATION 1571. FLORISTS.

Reference: Section 6012, Revenue and Taxation Code.

(a) Tax applies to amounts charged by a florist to ~~his~~ customers for the delivery of flowers, wreaths, etc., to points within California, even though ~~he~~ the florist instructs another florist to make the delivery, but in such case tax does not apply to amounts received by the florist making the delivery.

(b) Tax applies to amounts charged by florists who receive orders for the delivery of flowers, wreaths, etc., to points outside this state and instruct florists outside this state to make the delivery.

(c) The measure of tax includes charges made for telegrams or telephone calls whether or not the charges are separately stated. A "relay" or other service charge, made in addition to the charge for the telegram or telephone call, must also be included in the measure of tax.

(d) Tax does not apply to amounts received by California florists who make deliveries in this state pursuant to instructions received from florists outside this state.

(e) For purposes of this regulation and only this regulation, the term "florist" means a retailer who conducts transactions for the delivery of flowers, wreaths, etc. through a florist's telegraphic, telephonic, or electronic delivery association, except that the term "florist" shall not include any retailer that does not fulfill orders for the delivery of flowers, wreaths, etc. Tax applies to charges by a retailer that is not a "florist" for flowers, wreaths, etc. that will be delivered within California. When delivery is outside California, a retailer that is not a "florist" shall report sales of flowers, wreaths, etc. as provided in Regulation 1620. When a retailer who is not a florist instructs a florist to make a delivery of flowers, wreaths, etc., tax does not apply to the amounts received by the florist making the delivery.

Robert E. Cendejas
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VIA FACSIMILE (916) 322-4530
VIA E-MAIL: Lynn.Whitaker@boe.ca.gov

May 19, 2006

Mr. Jeffrey L. McGuire, Chief
Tax Policy Division (MIC: 92)
Board of Equalization
450 N Street
P.O. Box 942879
Sacramento, CA 94279-8092

RE: BTC-Reg. 1571- Florists;
Recommendation to Exclude
"Send Only" Florists from
the Regulation

Dear Mr. McGuire:

On behalf of my client, Just Flowers.com, I attended the first BTC meeting of interested parties regarding proposed revisions to Regulation 1571. Just Flowers.com is a "send only" florist. In other words, Just Flowers.com's sole function is to receive sales orders and forward the orders to one of the major floral delivery associations. It does not operate a traditional flower shop or directly handle flowers. It cannot and does not deliver orders for other florists.

In our opinion, the historical basis for Regulation 1571 was as an accommodation and a practical method for traditional flower shops to report their retail sales. Traditional flower shops both sent and received orders. Also, the volume of these orders from and to out-of-state flower shops was a very small percentage of their total sales. Additionally, the volume of these orders sent, reasonably approximated the volume of orders received by each flower shop. Therefore, historically, the approximately correct amount of California sales tax was paid collectively by all the California flower shops.

When Regulation 1571 was originally drafted, the current Internet sales operations were not contemplated or anticipated. Further, the "send-only" florists, by definition, are unlike traditional florists. "Send-only" florists do not receive offsetting delivery orders.

Also, 100% of their sales would have to be taxed by California under the Regulation. Therefore, imposing California sales tax under Regulation 1571 does not approximate the correct amount of California sales tax that California "send-only" florists should pay..

Further, the statutory basis of Regulation 1620 makes it a more substantive legal authority than Regulation 1571, which has no statutory basis.

Therefore, we strongly recommend that Regulation 1571 be clarified to indicate that it does not apply to "send-only" florists such as Just Flowers.com.

Very truly yours,

Robert E. Cendejas

Robert E. Cendejas

cc: Shane Garrett

CALIFORNIA STATE FLORAL ASSOCIATION

May 17, 2006

Jeffrey L. McGuire
Chief, Tax Policy Division
Sales and Use Tax Department
State Board of Equalization
450 N Street
Sacramento, California 94279

Reference: Regulation 1571, *Florists*

Dear Mr. McGuire:

On behalf of the California State Floral Association (CSFA) I would like to submit the following written response regarding Regulation 1571, *Florists*. We represent retail florists in the state and we participated in the May 2 meeting on this issue at the Board of Equalization offices.

With regard to the Regulation 1571, it is our read that our members are comfortable operating under this regulation notwithstanding the statutory authority issues raised at the meeting by several of the interested stakeholders. Our members have in the past supported continuation of this regulation. We would not necessarily rule out all potential changes to the existing regulation, however, any rewrite of the current regulation should do the following:

1. Be as uniform as possible with sales tax rules in other states.

2. Avoid duplicate taxation when orders are placed involving California and another state.

3. Be simple, easy to understand and easy to implement by the regulated community of retail florists. It should be very clear what sales are taxable and those which are not.

4. Be consistent and fair and provide for a level playing field. Similar competing types of flower sales should have equal sales tax obligations.

1521 "I" Street, Sacramento, CA 95814 • (916) 448-5266 FAX: (916) 446-1063
Website: www.calstatefloral.com

We do wish to state again as we did at the meeting, we do not see how having a reciprocal agreement with a floral delivery association is pertinent to the discussion about changing Regulation 1571. CSFA does not see this as relevant.

We understand the issues raised by some of the interested stakeholders at the meeting and are open to further discussion within the context of the criteria set forth above. We look forward to participating in the next meeting on June 22. Thank you for considering our views.

Sincerely,

R.L. Matteis
Director of Governmental Relations

cc: Lynn Whitaker

ROLL INTERNATIONAL CORPORATION

JORDAN P. WEISS
Vice President-Tax

May 18, 2006

Mr. Jeffrey L. McGuire, Chief
Tax Policy Division (MIC: 92)
Board of Equalization
450 N. Street
P.O. Box 942879
Sacramento, CA 94279-0092

Dear Mr. McGuire:

Enclosed please find two copies of Teleflora LLC's response to the Initial Discussion Paper issued by the Tax Policy Division, Sales and Use Tax Department, dated April 20, 2006.

Respectfully,

Jordan P. Weiss

JPW/sh

Enclosures

cc: Mr. Michael Parker, Dover Dixon and Horne PLLC
Ms. Lynn Whitaker (without enclosure)

11444 West Olympic Boulevard • Los Angeles, CA 90064-1544 • (310) 966-5754 • Fax: (310) 966-5795 • Mailing Address: P.O. Box 30119 • Los Angeles, CA 90030-0119

RESPONSE OF TELEFLORA, LLC
TO INITIAL DISCUSSION PAPER

Proposed revisions to Regulation 1571, *Florists*, to clarify the application of tax to sales by florists

Introduction. Teleflora, LLC was founded in 1934 and is the world's leading floral wire service, providing products, services and programs to approximately 30,000 member florists in the U.S. and Canada, and nearly 20,000 additional florists worldwide. These comments respond to the Initial Discussion Paper issued by the Tax Policy Division, Sales and Use Tax Department dated April 20, 2006.

Overview. The Discussion Paper asks: "Should Regulation 1571, *Florists*, be amended to clarify the application of tax to sales by florists where transactions do not involve a reciprocal agreement with a floral delivery association?" Teleflora accepts that some minor clarification of the Regulation may be in order. However, (a) the existence or absence of a reciprocal agreement with a floral delivery association should not be a determining factor; and (b) any change should continue to protect the retail florist who fulfills the order from responsibility to collect or remit tax, regardless of whether the order originates from a traditional retail florist or other floral sales business, or the domestic or international tax jurisdiction from which the order is received.

Discussion.

The Discussion Paper states: "Regulation 1571, *Florists*, was first adopted as Ruling 42 in 1933 to explain the application of tax to sales of floral arrangements where one florist accepts the order and instructs another florist to make delivery pursuant to a reciprocal agreement with a floral delivery association." Although Teleflora has not reviewed Ruling 42, this is not apparent on the face of the current regulation, and reciprocal agreements were not necessarily the basis for

floral statutes in other states. For example, *O'Brien et al. v. Isaacs, et al.*, 203 N.E. 2d 890 (Il., 1965) describes a tax controversy that existed in Illinois in 1965, prior to the passage of its florist sales statute in 1971.[1] In *O'Brien*, florists sent and accepted orders independently, and payment was made through a trade association clearing house. Neither reciprocal agreements nor a floral delivery association are mentioned in the case. In *O'Brien*, the Court found that an Illinois florist "who delivers flowers from his stock to the Illinois addressee" for a florist out of state was deemed to be the seller, responsible for tax. When Illinois clarified its law, it reversed this result for all transactions "in which the purchase order is received by a florist who is located outside Illinois, but who has a florist located in Illinois deliver the property to the purchaser or the purchaser's donee in Illinois."[2] The presence or absence of either a floral delivery association or a reciprocal agreement was not a determining factor.

Limiting any rule or regulation to florists participating in a floral delivery association, or to florists who both send and accept orders on a reciprocal basis would fail to recognize the many ways that florists can send and accept orders based on individual preference and modern technology. Teleflora recognizes that states are split as to whether floral delivery associations are a relevant consideration. Many states such as New Jersey,[3] Ohio,[4] Pennsylvania,[5] Tennessee,[6]

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[1]P.A. 77-53, §1 effective July 1, 1971.

[2]35 I.L.C.S. 105/3-5, 35 I.L.C.S. 120/2-5 (23).

[3]New Jersey State Tax News, Vol. 17, No.1, 01/01/1988.

[4]Ohio Administrative Code §5703-9-31.

[5]Pa. Code 61 §31.24(b).

[6]Tn. St. 67-6-907.

and Texas,[7] do not mention floral delivery associations in their law or regulations. On the other hand, some states such as Illinois[8] and New York[9] mention floral delivery associations in their regulations, although it is not clear if this is an operative distinction in Illinois, since its floral statute contains no such limitation.

Order Gatherers. The Discussion Paper goes on to describe two cases presented to the California Board of Equalization in March 2002 and February 2006. In both cases, the taxpayers were located in California but sold flowers exclusively through their web sites and toll-free numbers. The Discussion Paper describes the first seller as a "taxpayer" and the second seller as a "'send only' florist," and later refers to both as "Internet florist(s)," as distinguished from "traditional flower shop(s)."

In the floral industry, businesses that do business strictly on a remote sales basis, whether over the Internet or through central call centers, are commonly referred to as "order gatherers" to distinguish such floral sales businesses from traditional florists. Although all businesses that sell floral arrangements might be referred to as "florists" in a very general sense, the industry recognizes that it is less appropriate to refer to businesses that fulfill all orders through others as "florists" within the common usage of such term. Tennessee makes this distinction in its statutes by defining the term "retail florist" as "a seller who is primarily engaged in the retail sale of cut flowers and floral arrangements that are primarily either sold over-the-counter or delivered locally by the same florist."[10]

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[7]Tex. Admin. Code §3.307.

[8]86 I.L.A.C. §130.1965.

[9]NYCRR 20 §526.7(e)(3).

[10]Tn. St. 67-6-907 (2005).

In the floral industry, there are a multitude of businesses and organizations that make sales as order gatherers and subcontract the fulfillment of orders to others. These include associations, department store chains, and similar taxpayers that are primarily engaged in other retail businesses or organization activities, in addition to sellers that concentrate on floral sales through the Internet or call centers.

Teleflora believes that the common factor that distinguishes order gatherers from traditional florists is that under the common and accepted use of the term, florists regularly fulfill their own orders, and order gatherers do not. It is more logical to distinguish collection responsibility for sales tax based on this fundamental difference in the nature of these retail businesses, than on whether a business is a member of a floral delivery association, or fulfills orders for other florists on a reciprocal basis. Otherwise, the tax responsibility of two traditional florists in the same area might differ, based on whether they are members of an association, or make private delivery arrangements on an "*ad hoc*" basis, or whether they are willing to accept customary discounts to fulfill orders for others. Teleflora believes this would make florists that take advantage of the convenience of floral delivery associations less competitive, and would not be a prudent policy distinction under the circumstances.

Regulation 1571 and Regulation 1620. The issue the Board faced in the cases heard in March, 2002 and February, 2006 was that the Internet based retailers of floral products "argued that they should not be considered 'florists' for purposes of applying Regulation 1571. Rather the taxpayers believed that their sales should be reported under the standard rules for out-of-state sales provided in Regulation 1620, *Interstate and Foreign Commerce*."

Teleflora generally understands and accepts the Board's decisions with respect to this issue. This conclusion is not based on whether the order gatherers use a floral delivery

association to fulfill orders, or whether they accept orders from other businesses. Indeed, order gatherers concentrating on floral sales could have arrangements to accept orders from other order gatherers that offer flowers as an incidental part of their business.

The most logical reason for this distinction is that order gatherers are not in the same position to benefit from the protection afforded by the traditional florist protection statutes that traditional retail florists are. This is a different analysis than distinguishing on the basis of whether a retail merchant chooses to belong to a floral delivery association, or accepts reciprocal obligations as a part of its membership. The floral statutes were originally developed to protect the florist fulfilling an order for another florist out of state. In the early days of telegraph orders, some states were inclined to assess tax on the florists fulfilling telegraph orders notwithstanding that the florist accepting the order made the sale and entered into the actual sales agreement with the customer. Depending on the states, multiple taxes could be applied to the same transaction. See, e.g. *Johnson v. Cook*, 192 S.W. 2d 975 (AR 1946). The consistent tax treatment that has been adopted on a national basis is based on protecting florists accepting incoming orders from tax. Since order gatherers that do not fulfill orders as any part of their business do not have the same tax exposure as traditional florists, it is acceptable to place them under the standard rules for out-of-state sales provided in Regulation 1620.

Consistent Treatment of Fulfilling Florists. However, if the Department clarifies the tax treatment of order gatherers, it should also specify that the tax treatment of retail florists accepting orders by telegraph, telephone or other mode of communication from any out-of-state floral sales business will remain the same. Retail florists are not in a position to distinguish among orders from Internet businesses, "send only" businesses, or other traditional retail florists when they fulfill an order for another floral business. As a practical matter, many of these various

orders may come through common floral clearinghouses. And the fact that the orders are accepted by another floral seller, not the florist that fulfills the order, remains the same. If California chooses to change the collection responsibilities of order gatherers, this should not be done at the expense of the small businesses that fulfill the orders, and continue to need the protection the floral statutes and regulations were developed to provide. Any change such as that described in the Discussion Paper will necessarily place retail florists that accept orders for delivery out-of-state at a significant competitive disadvantage. Unfortunately, this is a situation faced by many other local merchants under existing federal law. Teleflora supports federal action to apply the same tax rules to local merchants and remote sellers. However, this is not within California's or Teleflora's ability to control at this time.

The Discussion Paper expresses concern that "the orders may escape taxation altogether when such orders are sent to out-of-state florists for fulfillment and delivery." The same concern might apply to incoming orders from other states, such as New York, that distinguish the collection responsibilities of order gatherers accepting orders in such states. However, taxation of all transactions has not controlled tax policy with respect to floral orders. If this had been the case, the states might have adopted a system of credits for taxes paid in other states to protect the transactions and florists from multiple and inconsistent tax treatment, such as in the general rule for use tax. Rather, the states recognized the need for a system that is relatively easy for these small businesses to administer, while serving their customer's needs. Furthermore, Professor Hellerstein has observed that in most instances, taxation of drop shipment gifts presents unique challenges:

> Summary of Law Relating to Drop-Shipment Gifts. In light of the foregoing discussion, the state of the law on drop-shipment gifts may be summarized as follows, assuming a purchase by Donor from Retailer in State A for delivery to Donee in State B, where Retailer has nexus: Goods purchased by Donor in State A

> for delivery to Donee in State B generally are not subject to sales or use tax in State A, due to the out-of-state shipment exemption. Similarly, goods purchased by Donor in State A for delivery to Donee in State B generally are not subject to sales tax in State B, because the sale will be deemed to have occurred in State A (where it is exempt under the out-of-state shipment rule). Moreover, goods purchased by Donor in State A for delivery to Donee in State B generally are not subject to a use tax in State B, because a purchaser (Donor) who does not take delivery in a state and has no nexus with the state will not likely be deemed to use such property in the state, and Donee will not be considered a user because of the lack of consideration associated with his or her use. ...
> Hellerstein and Hellerstein, *State Taxation*, ¶18.04[2][d] (3rd Ed., 2005).

More complete tax coverage exists in the area of floral orders among floral businesses than in most other interstate gift situations. Local florists should not be penalized or faced with more burdensome compliance responsibilities because California gives order gatherers special treatment with respect to their collection responsibilities.

Conclusion.

Teleflora would not object to clarifying Regulation 1571, *Florists*, to provide that order gatherers are subject to the standard rules for out-of-state sales provided in Regulation 1620. However, this change should apply to order gatherers as a class, and should not apply to retail florists under any circumstances; or be based on participation in a floral delivery association; or order clearing through a particular floral clearinghouse; or the other financial or logistical arrangements the order gatherers choose to make. The provisions for California florists who make deliveries in California pursuant to instructions received from florists outside the state should also be clarified to apply to instructions from any floral sales business that accepts floral orders and transmits instructions to a California florist from outside the state.